No. 92-319

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1992

BOARD OF COUNTY COMMISSIONERS OF SAN JUAN COUNTY,

Petitioner,

vs.

LIBERTY GROUP, A California Limited Partnership, NORMAN ANDREW GURLEY; LIBERTY PARTNERS, INC., A California General Partnership; F.M.G. PARTNERS, A California General Partnership; CHESTER ARTHUR WALKER, JR.; DOYLE LAVERNE HOLMES; ROBERT CLAYTON HOLMES; STEVE RAY HOLMES; LIBERTY CAPITAL MARKETS, INC., A California Corporation; PRUDENTIAL-BACHE SECURITIES, INC., A Delaware Corporation,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Tenth Circuit

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether a limited partnership can associate with, or be employed by, itself under 18 U.S.C. § 1962(c), Racketeering Influenced Corrupt Organizations Act ("RICO"), so that the limited partnership may be both the RICO "person" and the RICO "enterprise."

2. Was the Tenth Circuit correct in concluding that the trial court's scienter instruction improperly allowed liability under Rule 10(b)-5 (promulgated under the Securities and Exchange Act of 1934, 17 C.F.R. Section 240) formerely negligent conduct, and in concluding that respondents properly objected to the instruction.

LIST OF PARTIES[1]

Board of Commissioners of San Juan County, Petitioner
Liberty Group, A California Limited Partnership,
Respondent
Norman Andrew Gurley, Respondent

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[1] The caption used by Petitioner in lieu of a list of parties is the caption from the action in the district court and is over-inclusive. The parties listed in the text are the parties to Appeal 90-2266, which is the single appeal that raises the RICO and 10(b)-5 issues on which Petitioner seeks review. In the two related appeals, Liberty Capital Markets, Inc. (in 90-2275), and Liberty Capital Markets, Inc., Liberty Group, and Prudential-Bache Securities, Inc. (in 91-2166) were also parties. These appeals were not decided on the merits by the Tenth Circuit Court of Appeals as the Court's decision in 90-2266 mooted them. *See*, Slip Opinion at Appendix A to Petition, p. 16a. The remaining defendants listed by Petitioner in the caption prevailed at the trial and no appeal involving them was taken. None of the respondents to this petition are corporations.

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II. THE TENTH CIRCUIT COURT OF APPEALS PROPERLY DETERMINED THAT THE CRITICAL SCIENTER INSTRUCTION WAS FATALLY FLAWED BECAUSE IT PERMITTED A FINDING OF SCIENTER BASED ON MERE NEGLIGENCE, AND THAT RESPONDENTS HAD PROPERLY OBJECTED TO THE INSTRUCTION 10

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The respondents, Liberty Group and Norman Andrew Gurley, respectfully request that this Court deny the petition for writ of certiorari seeking review of the Tenth Circuit's opinion in this case. That opinion is reported at 965 F.2d 879 (10th Cir. 1992).

RESTATEMENT OF THE CASE

In late 1985, petitioner, through its then county treasurer, Ron Ashcroft ("Ashcroft"), commenced a new investment policy in which a portion of the funds that petitioner did not immediately need were invested in various government and government-backed securities. Ashcroft aggressively, and profitably, traded these bonds throughout the first half of 1986 when interest rates were falling and bond prices were, consequently, rising. During this period, Ashcroft used several different broker/dealers for petitioner's transactions, including some that he continued to use both during the period that he dealt with respondent Liberty Group and after he stopped using respondent Liberty Group.

In June of 1986, petitioner began using respondent Liberty Group as one of its broker/dealers for the purchase and sale of government and government-backed securities. Petitioner completed thirteen transactions with respondent Liberty Group, seven purchases and six sales, with the last transaction occurring in January 1987. Respondent Liberty Group's account executive in charge of the transactions with the County was respondent Norman Andrew Gurley ("Gurley"). At the time of the last transaction with respondent Liberty Group, petitioner

continued to hold one bond it had purchased from respondent Liberty Group. That bond was ultimately sold in 1989 through another broker/dealer. Petitioner suffered an out-of-pocket loss (that is, the difference between the dollars it paid to respondent Liberty Group to purchase bonds and the amounts it ultimately received back) of approximately $147,000.

In March 1988, petitioner filed suit against respondent Liberty Group. The final form of the complaint contended that respondents Liberty Group and Gurley had defrauded the County, in violation of Rule 10(b)-5 and RICO, by failing to reveal excessive mark-ups and concealing the mark-ups by adjusted trades (a trade made away from the market price in a manner that avoids recognition of a loss), and churned the account. There was substantial dispute at trial between the parties' experts over whether the mark-ups charged by respondent Liberty Group were excessive (and thus had to be revealed). In addition, there was a direct conflict in the evidence of Ashcroft and respondent Gurley and in the testiinony of the experts over whether the thirteen transactions over a six-month period constituted churning.

The jury returned a verdict in favor of all then remaining defendants (defendants Stephen and Robert Holmes, and Chester Walker were granted directed verdicts) except respondent Liberty Group, respondent Gurley, and Doyle Holmes. It found those three liable under Rule 10(b)-5 for damages of $188,223.09, and found respondents liable under RICO for treble damages and

attorneys' fees. The trial court granted Doyle Holmes' request for a JNOV, and respondents appealed.[2]

REASONS FOR DENYING THE WRIT

I. THE REQUIREMENT UNDER RICO § 1962(c) THAT THE "PERSON" BE DISTINCT FROM THE "ENTERPRISE" IS COMPELLED BY THE STATUTORY LANGUAGE AND HAS BEEN UNIFORMLY ADOPTED BY THE CIRCUIT COURTS OF APPEALS IN CIVIL CASES.

Section 1962(c) of RICO makes it unlawful "for any *person employed by or associated with any enterprise* . . . to conduct or participate . . . in the conduct of such enterprise's affairs through a pattern of racketeering activity . . . " (emphasis supplied). As the Tenth Circuit noted:

> "The language of the statute clearly contemplates that the 'person' charged will be distinct from the 'enterprise' since a person cannot logically be 'employed by or associated with' himself." Petition, Appendix A, p. 12.

Indeed, this case was pled, tried, and the jury was instructed (at petitioner's request), on this basis. The operative complaint, the Second Amended Complaint, alleged that the RICO enterprise was *an association in fact*

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[2] The Petition presents the "facts" in a completely one-sided manner and goes on at length, and misleadingly, about subjects, such as the exchange of correspondence between Doyle Holmes and petitioner and the amendment of the judgment, that have nothing whatsoever to do with the purported "Questions for Review" (Petition at pp. 3-5).

of Liberty Group, Liberty Partners, F.M.G. Partners, Liberty Capital Markets, Inc., Norman Gurley, Doyle Holmes, Prudential-Bache Securities, Inc., Chester Arthur Walker, Robert Holmes, Steve Holmes, and James Graham. Second Amended Complaint, ¶52, Joint App. at 62. The case was submitted to the jury on this basis[3]. Instruction No. 12, Joint App. at 260.

It was only in the district court's opinion ruling on the post-trial motions that the "enterprise" was identified as respondent Liberty Group. Memorandum Opinion and Order, Petition, Appendix B, at p. 22. Even then, petitioner, apparently conscious of the person-enterprise rule, did not take the position that respondent Liberty Group could be the enterprise or that the person did not have to be distinct from the enterprise under § 1962(c). Instead, on appeal, petitioner continued to insist that "The trial court correctly instructed the jury on the RICO claim" and quoted Instruction 12:

> "*the defendants and the enterprise cannot be the same and must be distinct.* The County has alleged that the Enterprise that existed in this case was in the form of a De Facto association; or an association in fact, between Liberty Group, Liberty Partners, Inc., FMG Partners, Liberty Capital Markets, Inc., Norman Andrew Gurley and Doyle Laverne Holmes." Petitioner's Answer Brief in No. 90-2266, at pp. 16-17. Emphasis supplied by petitioner.

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[3] Omitting, of course, the defendants who had by then been dismissed, to wit: Prudential-Bache, Robert Holmes, Steve Holmes, Chester Walker, and James Graham.

Petitioner then argued at length, contrary to the conclusion reached by the Tenth Circuit, that it had *factually* established an association in fact enterprise separate and distinct from the "person," respondent Liberty Group. *Id.* at pp. 18-25.

It is in its Petition that petitioner argues, for the first time, that respondent Liberty Group was the enterprise and strains to give an appearance of "conflict" in the interpretation of § 1962(c) over whether or not the "person" must be distinct from the "enterprise." The purported conflict is entirely artificial and does not exist.

Ten circuits have dealt with the requirement of a separate person and enterprise under § 1962(c) in civil cases and all ten have concluded that the "enterprise" and the "person" must be distinct, and in two of them, certiorari was sought, and denied, on this very issue. *See, Yellow Bus Lines v. Local Union 639,* 839 F.2d 782, *modified on other grounds,* 913 F.2d 948 (D.C. Cir. 1990) (en banc), *cert. denied,* ___ U.S. ___, 115 L. Ed. 2d 1007 (1991) and *Bennett v. United States Trust Co.,* 770 F.2d 308 (2nd Cir. 1985), *cert. denied,* 474 U.S. 1058 (1986). The remaining cases in which this interpretation was upheld are: *Garbade v. Great Divide Mining and Milling Corp.,* 831 F.2d 212, 213 (10th Cir. 1987); *Schreiber Distributing Co. v. Serv-Well Furniture Co.,* 806 F.2d 1393, 1396 (9th Cir. 1986); *Bishop v. Corbitt Marine Ways, Inc.,* 802 F.2d 122, 123 (5th Cir. 1986); *Schofield v. First Commodity Corp. of Boston,* 793 F.2d 28, 30 (1st Cir. 1986); *Horoco v. American National Bank & Trust Co. of Chicago,* 747 F.2d 384, 401 (7th Cir. 1984), *aff'd on other grounds* 473 U.S. 606 (1985); *B.F. Hirsch v. Enright Refining Co.,* 751 F.2d 628, 633 (3rd Cir. 1984); *Alexander Grant & Co. v. Tiffany Industries,* 742 F.2d 408, 411 n. 6 (8th

Cir. 1984), *judgment vacated on other grounds*, 469 U.S. 1205 (1984); *NCNB National Bank of North Carolina v. Piller et al.*, 814 F.2d 931 (4th Cir. 1987).

The only arguably contrary authority is *United States v. Hartley*, 678 F.2d 961 (11th Cir. 1982), *cert. denied*, 459 U.S. 1170 (1983), a criminal case which has never since been followed in any Court of Appeals on this point, and which is, in any event, quite different factually and legally from the cases following the person-enterprise rule, including this case. In *Hartley*, the corporate defendant and two employees had masterminded a scheme in which defective breaded shrimp was sold to the military by elaborate ruses and with the assistance of bribed government inspectors. The corporate defendant and the two employees were convicted of conspiracy, mail fraud, and violation of § 1962(c). A challenge was mounted to all of the convictions raising some 14 arguments. As to RICO, the challenge was to the indictment, claiming it was invalid because it failed to allege that the "person" and the "enterprise" were separate. The Court of Appeals rejected this challenge noting that, in any event, an association in fact of the company, the employees, and the government inspectors was proven and could have been alleged in the indictment. This should be contrasted with this case, in which an association in fact was *alleged*, but not *proven*. In view of the distinguishing factual features of *Hartley*, and its uniform rejection as a precedent in civil cases by all of the circuits that have dealt with the issue, there is no basis for concluding that there is any real conflict between the circuits.

The balance of petitioner's attempts to create the appearance of a conflict are a mishmash. Petitioner

asserts that several cases reflect conflicts within circuits. However, in each instance, the purported conflict is illusory. The court in each case reaffirms the requirement of different entities for the "person" and the "enterprise" under § 1962(c) because of the associative and employment requirement. At the same time, these courts noted that under § 1962(a), different entities are not required because that subsection does not have an associative or employment requirement, but rather an investment requirement.[4]

Thus, in *Masi v. Ford City Bank and Trust Co.*, 779 F.2d 397 (7th Cir. 1985), the court stated:

> "We held that subsection (c) *did* require separate entities as the person and the enterprise . . . " (emphasis supplied), but concluded that (a) did not because " 'Subsection (a) does not contain any of the language in subsection (c) which suggests that the liable person and the enterprise must be separate.' "

The situation is the same in the other two cases cited by the County. In *Garbade v. Great Divide Mining and Milling Corporation, supra,* the court said:

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[4] In two of the cases, *United States v. Benny,* 559 F. Supp. 264 (N.D. Cal. 1983), *affd.*, 786 F.2d 1410 (9th Cir. 1986), *cert. denied,* 479 U.S. 1017 (1986) and *McCullough v. Suter,* 757 F.2d 142 (7th Cir. 1985), the issue was not whether there had to be a distinction between the "person" and the "enterprise," but rather whether there was such a distinction between an individual and his multi-employee sole proprietorship, and held that on the facts of those cases, there was such a distinction. In both cases the Courts of Appeals reaffirmed the basic rule as to the person-enterprise distinction. *Benny,* at 786 F.2d 1416, and *McCullough* at p. 144.

> "The complaint further alleges that the corporate defendant, Great Divide, violated 18 U.S.C. § 1962(c). The trial court dismissed the corporation on the ground that it could not in these circumstances be both an "enterpirse" and a "person" within the purposes and wording of the section. *We must agree.*" (emphasis supplied).

Similarly, in *Schreiber Distributing Co. v. Serv-well Furniture Co., supra,* while the court, in dealing with § 1962(a) did not require a distinct "person" and "enterprise," it adopted the reasoning of the Seventh Circuit in *Horoco, supra,* which required such a differentiation under § 1962(c).

There is no conflict among the circuits, or within any circuit, over the "person-enterprise" rule under § 1962(c). The uniform, routine interpretation is that the language of subsection (c) compels proof of an enterprise separate and distinct from the person charged. This case was pled and tried on this basis and the jury was so instructed. Petitioner's difficulty in this case arises not from any misinterpretation of the statute, but from its fundamental failure of proof of the enterprise (an association in fact) that it alleged.

Having failed to demonstrate any conflict between the circuits in interpreting § 1962(c), petitioner turns to an attempt to persuade that this clear issue of statutory interpretation is somehow an "important issue of law" that should be decided by this court. This attempt also fails; indeed, it seems to go nowhere.[5] It provides no

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[5] Perhaps the explanation for the somewhat odd, out of place, feel to much of petitioner's brief on the RICO issue is that

meaningful analysis of the current rule and makes no real attempt to explain how its vaguely articulated "alternative" would work in practice or, more importantly, in the context of this case. It is no more than an abstract, obtuse, discussion of principles of vicarious criminal liability as somehow related to the interpretive question presented.[6] It offers no basis for a grant of the Petition.

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it is copied, word-for-word, but completely out of context, and without attribution, from a copyrighted law review article: *Innocence by Association: Entities and the Enterprise Rule Under RICO*, 63 Notre Dame L. Rev. 179 (1988) (except for the insertion of "limited partnership" wherever corporation appears, and the placing in text of some footnote references). For example, the entirety of subsection D. "An Alternative Approach" (at pp. 15-18) is taken word-for-word from the law review article at pages 208-212. In addition, approximately a third of pages 7-13 of the Petition are also copied in bits and pieces from the law review article. It is not particularly surprising that this "cut and paste" analysis leads nowhere. Interestingly, petitioner omits any reference to the conclusion of the article which is that the whole person/enterprise rule should be abandoned and replaced with application of *criminal* rules relating to vicarious liability, including a requirement that the "person" intended to benefit the enterprise. Of course, adopting such a rule, which is of dubious value, would have no effect in this case in which there was no effort to plead or prove that respondent Gurley "intended to benefit" respondent Liberty Group by his challenged conduct; this case, at petitioner's insistence, was tried on an association in fact theory.

[6] *See*, footnote 5, *supra* for the probable explanation.

II. THE TENTH CIRCUIT COURT OF APPEALS PROPERLY DETERMINED THAT THE CRITICAL SCIENTER INSTRUCTION WAS FATALLY FLAWED BECAUSE IT PERMITTED A FINDING OF SCIENTER BASED ON MERE NEGLIGENCE, AND THAT RESPONDENTS HAD PROPERLY OBJECTED TO THE INSTRUCTION.

The Petition makes absolutely no attempt to demonstrate that the questions posed by the Tenth Circuit's ruling on the scienter instruction fit any of the accepted criteria for granting certiorari, and indeed, they do not.

There is no dispute that Rule 10(b)-5 liability requires scienter and that mere negligence is not enough to supply that scienter. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, *reh'g denied*, 425 U.S. 986 (1976). The issues posed to the Court of Appeals were two: first, did the instruction given prejudicially permit recovery for mere negligence; and second, did respondents properly object to the scienter instruction in accord with Federal Rules of Civil Procedure, Rule 51. The first issue poses a straightforward analysis of the instruction to determine whether the language used in one prong of the instruction permitted liability for mere negligence, and a fact-bound determination of whether the error was prejudicial. The second issue is at root simply a factual inquiry into whether the objection made adequately alerted the district court judge to the flaw in the instruction so that he could and should have altered it. Both issues, since the instruction objected to was not a standard jury instruction, present no issue of broad application; they are applicable simply and solely to this case.

In any event, the Tenth Circuit's decision was clearly correct. The instruction given (Instruction 24, Joint App. 274) had four prongs to it. The four prongs require a showing that the defendant: (1) made material statements which he knew to be false; or (2) made statements with a reckless disregard for their truth or falsity; or (3) knew of the existence of material facts which were not disclosed and he should have realized their significance in the making of an investment decision; or (4) knew of the existence of material facts which were not disclosed although he knew that knowledge of those facts would be necessary to make his other statements not misleading.

The first prong is a plain vanilla misrepresentation of a material fact; the second prong a reckless misrepresentation.[7] The fourth prong is omission of a fact *knowing* that knowledge of the fact is necessary to make the parties' other statements not misleading. The problem is the third prong. It should have been the "reckless" equivalent of the fourth prong; that is, it should have allowed a finding of scienter if the defendant *recklessly* disregarded whether or not disclosure of the fact would be significant in making an investment decision, i.e., necessary to make

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[7] This portion of the instruction is also faulty because it omits materiality as a factor with respect to this prong, and does not contain a definition of "recklessness," both of which were contained in the instructions requested by respondents. On appeal, however, respondents did *not* rely on these errors, preferring to focus on the more obvious flaw in the scienter instruction. For reasons difficult to fathom, the Petition, at pp. 20-21, acts as if the Tenth Circuit had reversed and remanded for failure to include a definition of "recklessness" in the instructions when in fact it did not.

his other statements not misleading. Instead, it says "should have realized [known]" that the facts should be disclosed. This is the language of negligence, not recklessness, and the Tenth Circuit so held.

As factually the evidence on scienter was close, the Court of Appeals found the error prejudicial. Since respondents specifically objected to the instruction, and in particular the third prong, on the grounds that under the *Hochfelder* case, "you have to show something more than this, which would be more of a simple[] negligence standard instead of a gross negligence standard," it is difficult to comprehend why petitioner claims a failure to properly object. As the Tenth Circuit noted:

> "The defendants' objection that *Hochfelder* requires a finding of gross negligence rather than simple negligence was sufficient to fully inform the court of the specific nature of and grounds for the objection." Slip Opinion, Petition, Appendix A, at p. 10a.

The scienter instruction, respondents' objection to it, and the Tenth Circuit's ruling raise no issues on which the courts are in conflict or of broad legal significance; they are heavily related to the specific facts of this case and no reason for granting the petition exists.

III. CONCLUSION

Respondents respectfully submit that application of the person-enterprise rule to require under § 1962(c) that the person be distinct from the enterprise results from a straightforward reading of the section, a reading given to

it by all of the circuit courts that have considered it in civil cases. Moreover, with respect to the scienter instruction, petitioner gives no reason for granting certiorari, and the issues with respect to it were correctly decided. Accordingly, no reason exists for a grant of the petition.

WHEREFORE, respondents respectfully pray that the Writ of Certiorari be denied.

Respectfully submitted,

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